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UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

UNITED STATES OF AMERICA,

Plaintiff,

v.

THE PRESIDENT AND FELLOWS OF HARVARD COLLEGE, ANDREI SHLEIFER, JONATHAN HAY, NANCY ZIMMERMAN, and ELIZABETH HEBERT,

Defendants.

Civil Action No.

00cv11977DPW

RECEIPT # N/A
AMOUNT $ N/A
SUMMONS ... YES

Eric Schlupf
9/26/00

COMPLAINT AND JURY TRIAL DEMAND

I. INTRODUCTION

1. The United States alleges that Harvard University ("the President and Fellows of Harvard College" or "Harvard") and its employees, Andrei Shleifer and Jonathan Hay, defrauded the United States out of at least $40 million dollars paid to Harvard to provide impartial and unbiased advice in connection with a United States' assistance program in Russia. The United States alleges that Shleifer and Hay abused their positions as high-level and trusted advisors to and on behalf of the United States in Russia, and misused resources funded by the United States for their own personal benefit and the personal benefit of their wives, girlfriends and/or business associates. Harvard, which was paid by the United States to provide impartial and unbiased

administration and oversight of the assistance program in Russia, failed in its obligation to provide such oversight, and instead mismanaged and abused the resources entrusted to it by the United States. As a result of Defendants' misconduct, the United States suspended and ultimately terminated the Harvard project in Russia.

2. The United States alleges that Defendants' actions undercut the fundamental purpose of the United States' program in Russia -- the creation of trust and confidence in the emerging Russian financial markets and the promotion of openness, transparency, the rule of law, and fair play in the development of the Russian economy and laws.

3. During the course of the Harvard project in Russia, Defendants submitted and/or caused to be submitted to the United States false and/or fraudulent bills and other statements. These bills and statements falsely and/or fraudulently represented that Harvard, Shleifer, Hay and others under their direction were providing impartial, unbiased advice pursuant to policies which forbade investments in Russia, and that Harvard was providing services in accordance with the terms and conditions of its agreements with the United States.

4. The United States paid at least $40 million to Harvard because of Defendants' false and/or fraudulent representations that Harvard, Shleifer and Hay were providing services which were free from bias and in accordance with the agreements between the

parties. The United States also paid at least $350 million to other contractors under the oversight and supervision of Harvard.

II. JURISDICTION

5. This is an action for diversion of money paid under a federal grant program, including claims for false claims, fraud, and breaches of fiduciary duty. The case arises under the False Claims Act, 31 U.S.C. §§ 3729 et seq., equitable principles and common law. This Court has jurisdiction pursuant to 28 U.S.C. § 1345.

III. VENUE

6. Venue lies in the District of Massachusetts pursuant to 28 U.S.C. § 1391(b) and 31 U.S.C. § 3732(a), as the place where one or more of Defendants reside and where a substantial part of the events or omissions giving rise to the claim occurred.

IV. PARTIES

7. Plaintiff is the United States of America on behalf of its agency, the United States Agency for International Development ("USAID").

8. Defendant Harvard is a non-profit corporation with a principal place of business in Cambridge, Massachusetts. Its operations at all relevant times included the Harvard Institute for International Development ("HIID"), which implemented Harvard's contracts with the United States to assist developing countries such as Russia. HIID is a part of Harvard and not a

legally distinct corporate entity.

9. Defendant Andrei Shleifer ("Shleifer") is an individual now residing in Newton, Massachusetts. At all relevant times, Shleifer was and is a tenured Professor of Economics at Harvard and a full-time Harvard employee. Shleifer was the Principal Investigator and Project Director for USAID funded agreements with Harvard for work on economic and legal reforms in Russia (the "Project"). As such, he had primary responsibility for proper management of the Project, as well as the obligation to insure adherence to all terms and conditions of the agreements with USAID. During at least some periods of time, including the summers of 1993 and 1994, as well as from July 1, 1995 through August 31, 1996, Shleifer requested that he be "employed" under the Cooperative Agreements, and during those periods was paid by Harvard and billed by Harvard to USAID as a full-time employee on the Project.

10. Defendant Jonathan Hay ("Hay") is an American citizen now residing in Moscow, Russia. From approximately 1992 to May 1997, Hay was a Harvard employee serving as Harvard's Moscow-based representative (General Director) in charge of the Project. Hay managed Harvard's USAID funded operations in Russia and oversaw the activities of many USAID funded consultants to the Russian government. Hay reported directly to Shleifer.

11. At all relevant times, in connection with their actions

related to the Project, Shleifer and Hay were acting within the scope of their authority and/or their apparent authority based upon their positions at Harvard.

12. Defendant Nancy Zimmerman ("Zimmerman") is an individual residing in Newton, Massachusetts. At all relevant times, she was and is married to Defendant Shleifer. Beginning in June 1994, Zimmerman operated an investment fund management company known as Farallon Fixed Income Associates ("FFIA") in Cambridge, Massachusetts. FFIA was a joint venture between Fixed Income Associates ("FIA"), a company owned by Nancy Zimmerman, and Farallon Capital Management, Inc. ("Farallon Capital"), a separate San Francisco based company which is associated with a number of investment funds and partnerships bearing the Farallon name. Both individually and through FFIA, Zimmerman was involved in a number of investments and financial transactions in Russia and utilized the USAID funded staff and resources of the Harvard project to assist her with these investments.

13. Defendant Elizabeth Hebert ("Hebert") is an American citizen now residing in Moscow, Russia. She is married to Defendant Hay, and has been together with him in a close personal relationship since at least December 1995. She is the founder and manager of Pallada Asset Management ("Pallada"), the Russian mutual fund management company which received the first license to operate a mutual fund in Russia.

V. FACTUAL BACKGROUND

14. After the Soviet Union dissolved in December 1991, the United States began providing limited assistance to support reform efforts in the states of the former Soviet Union. In October 1992, Congress enacted the Freedom for Russia and the Emerging Eurasian Democracies and Open Market Support Act of 1992. 22 U.S.C. §§ 5801 et seq. This Act authorized a program, to be implemented primarily by USAID, to help the states of the former Soviet Union carry out political and economic reform in support of open markets, including "establishment of transparency in regulatory and other governmental decision making." 22 U.S.C. § 5811(6)(B). USAID sought to accomplish the task, in part, through two Cooperative Agreements with Harvard.

A. The Cooperative Agreements

15. In December 1992, USAID and Harvard entered into the first Cooperative Agreement, pursuant to which Harvard agreed to provide advisory teams to assist Russia in efforts to privatize assets held by the government. The scope of this Cooperative Agreement was later expanded to provide support for legal reform and capital market initiatives. The Cooperative Agreement stated that "HIID's role in the project is unique in that it... operate[s] in a supervisory and regulatory capacity to the overall project." The Cooperative Agreement included a component for

Harvard to assist in developing laws and regulations to "ensure competition, transparency and fair play" in, among other things, the development of the securities market.

16. Harvard signed a second Cooperative Agreement with USAID in October 1995, entitled "Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs in Russia." Harvard's role was to provide strategic guidance to the capital market development effort. This guidance included coordination and impartial oversight over various contractors engaged by USAID to provide assistance to Russian institutions. The Agreement stated: "The ultimate success of these programs is of the utmost importance to USAID and to the Government of Russia." It also provided that Harvard "shall provide unbiased input to, and overall day-to-day management, review and evaluation of, the privatization and market reform programs." The Agreement further provided that the "recipient must develop the complete confidence and trust of the host government and also the array of donor agencies" and that "a completely neutral third party, void of any vested interest in the contracting process, is required."

17. In implementing these Cooperative Agreements, Harvard, Shleifer and Hay undertook to act on behalf of the United States in overseeing a program to provide advice to Russia, to act as advisor to USAID on what policies to pursue, and to assist in managing the privatization and post-privatization assistance

effort in Russia. By virtue of these undertakings, Harvard, Shleifer and Hay owed fiduciary duties, including a duty of loyalty and utmost good faith, to the United States. These duties included the duty not to engage in any conduct which could result in conflicts of interest, and to disclose any financial interests they had in the matters within the scope of their advice and management.

18. Harvard, Shleifer and Hay understood that they had undertaken to implement the United States' strategic goals in Russia and to act on behalf of USAID. For example, in its First Quarter 1995 Performance Report to USAID, Harvard stated: "In the first quarter of 1995, Professor Andrei Shleifer of Harvard University continued to direct technical assistance on behalf of the U.S. Agency for International Development through a Cooperative Agreement with HIID."

19. Similarly, in the 1996 Workplan submitted to USAID, Harvard stated: "At all times, HIID will emphasize the strategic policy objectives of the U.S. government."

20. Shleifer himself explained the significance of this work to the United States. In his 1995 book, Shleifer wrote:

> Western governments give aid to Russia not because they are charitable, but because their own national security interests demand a stable and peaceful transition from communism. Economic aid to Russia is probably the least expensive and most effective form of defense spending by either the United States or Western Europe.

Maxim Boycko, Andrei Shleifer and Robert Vishny, <u>Privatizing</u>

Russia 142-43 (1995).

B. Specific Conflict of Interest Prohibitions

21. In addition to the prohibitions against investing in Russian markets which were inherent in their positions, Shleifer and Hay were subject to government contract provisions, government regulations and internal Harvard policies concerning impartial and unbiased advice and conflicts of interest. For example, employees of the grantee, Harvard, were prohibited by the specific terms of the Cooperative Agreements from investing in a country in which they were assigned work. Both Cooperative Agreements provided:

> [N]o employee of the grantee shall engage directly or indirectly, either in the individual's own name or in the name of or through an agency of another person, in any business, profession, or occupation in the foreign countries to which the individual is assigned, nor shall the individual make loans or investments to or in any business, profession or occupation in the foreign countries to which the individual is assigned.

22. This Agreement also provided that any violation of the policy had to be reported by Harvard to USAID.

23. In addition, the Cooperative Agreements incorporated 22 C.F.R. § 226.42 or its similar predecessor provision. 22 C.F.R. § 226.42 provides:

> [T]he recipient shall maintain a code of standards of conduct that shall govern the performance of its officers, employees or agents in the awarding and administration of contracts using AID funds. Conflict of interest situations involving employees, officers or agents or their immediate families shall be avoided. The recipients' officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors or potential

contractors.

24. HIID's Overseas Manual, which was provided to USAID, also contained a conflict of interest policy which restricted the activity of HIID employees and members of their families when conducting work in other countries. It provided:

> HIID employees and members of their families may engage in no financial transactions or investments within the Project Country .... Such transactions or investments include maintenance of savings accounts or the purchase of savings certificates, holding of debt instruments, maintaining any interest whatsoever in any local business, or making investments of any kind in the Project Country.

25. Harvard's Faculty of Arts and Sciences, of which Shleifer was a member, also had a conflict of interest policy which required the disclosure of potential conflicts of interest, including any relationship "that might enable a member to influence Harvard's dealings with an outside organization in any way leading to personal gain or to improper advantage for anyone."

26. In its June 1995 submission to USAID in connection with its proposal for the second Cooperative Agreement, Harvard included a required Conflict of Interest Statement, which stated:

> As a non-profit, academic institution, Harvard is committed to maintaining an objective and unbiased role.... In substance and principle, HIID already provides impartial oversight under its current Cooperative Agreement.

C. <u>The Investments</u>

27. While they were acting on behalf of USAID and under the restrictions described above, Shleifer and Hay, along with

Zimmerman and Hebert, engaged in at least the following investments and businesses in Russia in areas that were within the scope of their economic and legal advice on behalf of USAID:

(i) In 1994, Shleifer and his wife Zimmerman invested $200,000 through Renova-Invest, a United States/Russian investment entity, in various Russian companies, including an aluminum company for which Hay and others funded by USAID later provided legal services. Through Renova-Invest, Shleifer and Zimmerman also invested $60,000 in Russian government debt ("GKO's");

(ii) Also in 1994, Shleifer, Zimmerman and Hay purchased several hundred thousand dollars worth of shares in Russian oil companies and had the shares registered in the name of Shleifer's father-in-law;

(iii) Hay, Zimmerman, Hebert and Shleifer participated in the launching and financing of (i) Russia's first licensed mutual fund, which was started by a company (Pallada) founded and managed by Hay's then girlfriend (now wife) Hebert, and/or (ii) Russia's first licensed mutual fund depository, the First Russian Specialized Depository ("FRSD"), which was started by Hebert's business partner, Julia Zagachin;

(iv) Hay and Hebert participated in creating a real estate advisory/property management firm to work with Hebert in starting a real estate mutual fund, and to lease properties to and manage properties for a project to which Hay was a key advisor; and

(v) Hay assisted Zimmerman in her efforts to trade short term Russian government bonds ("GKO's") and other government debt and repatriate the profits from such trades without paying the required Russian repatriation tax, and used USAID funded staff and offices to set up and operate a Russian trading company to implement this scheme.

(i) Shleifer's and Zimmerman's Investment in Russian <u>Stocks Via Renova-Invest</u>

28. On July 13, 1994, at a time when he was being paid for full-time work on the Project with USAID funds, Shleifer and his

wife made a $200,000 investment in Russian stocks through a company known as Renova-Invest ("Renova"), a United States/Russian investment group.

29. Specifically, in a July 13, 1994 letter, Shleifer agreed to invest $200,000 in Russian securities through Renova. On the same date, $200,000 was wired to Renova from an account of Zimmerman.

30. The stocks purchased through Renova included many of the major Russian companies which had been and were being privatized under plans for which Shleifer was a key advisor. These companies included Rostelcom, Gazprom, Irkaz, Sayansk, Bratsk, Vladimir Tractor and Chernogoroneft.

31. In addition, in 1995, $60,000 of these funds and/or the proceeds from sale of these stocks were invested in GKO's (short term government bonds) at a time when Shleifer, while being funded by USAID, was involved in advising the Russian government on debt policy and negotiations with the International Monetary Fund concerning further extensions of credit to the Russian government.

32. Following these investments, USAID funds were used for the benefit of the companies in which Shleifer and his wife Zimmerman had invested. In 1995, Renova's Russian affiliate needed legal counsel in Russia to assist it in vertically merging aluminum companies, including Irkaz, one of the companies whose stock Renova had purchased for Shleifer. Based upon Shleifer's

recommendation, Renova hired Hay and other USAID funded staff working with Hay to perform these legal services.

33. Hay worked on the merger documents himself, and used several USAID funded lawyers to work on the transaction. The time spent by these lawyers working on this private merger was charged to USAID.

34. In addition, Harvard's USAID funded projects provided direct assistance to other companies in which Shleifer had invested through Renova. Moreover, much of Harvard's work on privatization and post-privatization issues such as market development, taxation, budget, and competition policy had at least a potential impact on the value of stock in these major Russian companies.

(ii) Shleifer and Hay's Oil Stock Purchases With Farallon Capital and CentreInvest

35. Also in July 1994, Shleifer and Farallon Capital agreed to purchase oil stocks in Russia. They agreed that for each purchase, Shleifer would invest 10% of the funds and Farallon-related entities would invest 90% of the funds.

36. Although Shleifer agreed to invest his own capital in these oil stocks, he arranged for his investment in these stocks to be concealed by having them held in the name of another. At first this was to be Zimmerman, but the shares were ultimately registered in the name of Zimmerman's father.

37. Thus, Shleifer wrote, in the first of two memoranda

dated July 28, 1994:

> The initial investment is anticipated to be $2 million, with increase to $5 million if sufficient investment opportunities are available. Andrei will invest 10 percent as his own capital, with shares to be registered to Nancy Zimmerman.

Then, in a second July 28, 1994 memorandum, Shleifer changed this language to "Shleifer will invest 10 percent as his own capital, with shares to be owned by Nancy Zimmerman."

38. True and accurate copies of the first and second July 28, 1994 memoranda described above are attached as Exhibit A and Exhibit B respectively.

39. Farallon Capital and Shleifer made three sets of purchases of oil stocks through CentreInvest in the late summer and fall of 1994. In each instance, 90% of the shares were purchased in the name of Farallon-related funds, and 10% were purchased in the name of Shleifer's father-in-law, with all or some of the funds for Shleifer's 10% coming from Shleifer, Nancy Zimmerman and Hay, as set forth below:

(A) On August 11, 1994, Shleifer wired $165,000 from his joint checking account with Nancy Zimmerman to a Channel Islands bank for the purchase of 30,000 shares of the Russian oil company Purneftegas.

(B) On August 31, 1994, Shleifer sent a $99,000 check from his own money market account to his father-in-law, who in turn wired $165,000 to a Channel Islands account for the purchase of 5,000 shares of the Russian oil company Yuganskneftegas.

(C) On September 20, 1994, Shleifer deposited a $66,000 check from Hay to Shleifer into Shleifer's individual account. At that time, there was approximately $3,000

in Shleifer's account. Shleifer deposited an additional approximately $6,000 in the account. No other funds were deposited in that account prior to November 4, 1994. On November 4, 1994, Shleifer wired $19,000 from this account to a Channel Islands account for the purchase of 1,000 shares of stock of the Russian oil company Varieganneftegas.

40. Out of the $19,000 wired by Shleifer to purchase the Varieganneftegas shares on November 4, 1994, a minimum of slightly less than $10,000 of Hay's funds was used.

41. Nonetheless, approximately five months after the USAID investigation into these matters began, in August 1997, Shleifer sent a $66,000 check to Hay's father with a note claiming that he had not been able to put the funds to any "good use." Although Shleifer had the use of his subordinate's funds for almost three years, he paid no interest on the $66,000 to Hay.

42. Just before these oil stock purchases began, Hay directed a USAID funded Harvard employee to do research on the price of Russian stocks, including specifically gathering price quotes on Russian oil stocks and reporting those to Hay in a written memorandum. Hay also used another USAID funded employee and a USAID funded contractor to have these oil stock purchases confirmed in the Russian registries of the companies purchased.

(iii) Involvement in the First Russian Specialized Depository and Pallada Asset Management

43. Beginning in late 1995 or early 1996, Hay, Hebert, Shleifer, Zimmerman, and USAID funded Harvard employee Julia Zagachin, put together, promoted and/or financed a plan to launch

the first Russian mutual fund management company ("Pallada") and the first Russian specialized depository ("FRSD"). These businesses were predicted to be quite profitable and both required licenses from the Russian Securities Commission, an entity which Harvard, Shleifer and Hay helped establish and to which Harvard, Shleifer and Hay were key advisors. Both Pallada and the FRSD received the first operating license of their kind ever issued by the Russian Securities Commission.

44. Hay actively solicited investments in Pallada and the FRSD from Zimmerman, the Farallon companies and others. Hay traveled to Boston to participate in some of the meetings with representatives of at least one potential investor, Aldrich, Eastman & Waltch and/or its affiliates ("AEW").

45. On or about March 29, 1996, Hebert sent to AEW affiliate Commonwealth Property Investors ("CPI") a business plan (the "Business Plan") to create a Russian domestic fund management company to launch one of the first mutual funds in Russia. The Business Plan for what was to become Pallada and the FRSD sought investors to contribute $3.5 million in exchange for 30% of the equity of the proposed company. The Business Plan predicted that the company would generate $28 million annually in pre-tax profits in the first five years of operation. It stated that the management team would "consist of a Chief Executive Officer, Elizabeth Hebert, and a Chief Operating Officer, Julia Zagachin."

At the time, Zagachin was being paid as a full-time employee of Harvard on the USAID funded Project under Hay's supervision, while in fact working on starting this private mutual fund and/or depository business with Hebert.

46. Hebert and Zagachin planned to use their close relationship with the Russian Securities Commission to which Hay was a key advisor to gain a competitive advantage over other funds. The Business Plan stated:

> The timing is critical to ensure the Fund is able to benefit from expected barriers to entry, the first of which is an untested licensing procedure for the fund management company. ... It is expected that the fact that the team is well known to and trusted by the regulators suggests that it will be able to facilitate the issuance of licenses and clear other regulatory hurdles which are expected to be a hindrance to competitors.

47. Hebert also indicated that she and Zagachin intended to use the services of the Institute for Law-Based Economy ("ILBE"), a Russian affiliate of the Harvard Project under the direction of Hay and largely funded by USAID. The Business Plan stated:

> [I]t will also be important to develop solutions in close co-operation with the Federal Commission which intends to carefully regulate these functions. ... To ensure full compliance the Institute for Law-Based Economy (the Russian non-profit that drafted the Regulations) has already been retained to provide advice in the consideration of various options and to facilitate the development of those options where regulatory assistance is required.

48. In a May 20, 1996 memorandum, Hay solicited investments in the proposed mutual fund depository business. Attached as

Exhibit C is a true and accurate copy of the memorandum from Hay to Zimmerman, except that the handwritten notes thereon were added by Zimmerman. This memorandum was faxed from Hay's office to the office of Zimmerman.

49. In this solicitation memorandum, Hay stated that "we" are seeking an investment of $1.2 million in the FRSD. In the memorandum, Hay noted that the regulations governing mutual funds "were drafted by the Russian legal team that I manage." He touted the likely success of the investment based primarily on its close relationship with the Russian Securities Commission, and specifically stated that "we are likely to get a license before anyone else which will give a significant first mover advantage." Hay also stated: "Given this project's relationship to the Federal Commission, any other attempts by definition will be in a catch up mode."

50. In this memorandum, Hay described the proposed mutual fund management company as part of a package together with the proposed mutual fund depository (which was actually supposed to act as an independent watchdog with respect to such mutual fund management companies). Hay stated: "We are not interested in your investment in the Specialized Depository unless this is helpful to raise the funds needed to start the Fund Management Company [being created by Hay's girlfriend Hebert]" because, among other things "we frankly want to start both of these things at the

same time and are tying our futures to this strategy."

51. In the memorandum, Hay also stressed the expected profitability of the business. The memorandum stated:

> [I]f we were to assume that this Specialized Depository has a large market share and that it were to process millions of accounts, it would be an extremely profitable operation! We are certainly well positioned to achieve such success if Yeltsin wins the election and the mutual fund industry booms in Russia (and we expect both of these things to happen).

52. Beginning at least in early 1996, Zimmerman and/or Shleifer planned to invest in Pallada and/or the FRSD. Zimmerman planned to be the lead investor, assisted in the structuring of the transactions, and solicited others to participate with her in the investments, including AEW and/or its affiliates. Shleifer had knowledge of at least some of these plans and attended at least one meeting with AEW representatives where AEW's and Zimmerman's potential investments in Pallada and the FRSD were discussed. He and Zimmerman also traveled to Moscow to meet with Zagachin, Hebert and Hay concerning these plans and investments, and contributed funds for the financing of Pallada, as set forth in greater detail below.

53. On or about May 1, 1996, Zimmerman wrote a memorandum to Hebert and Zagachin in which Zimmerman stated that her "investor group is interested in acquiring 49% of the depository in exchange for $600,000.00 in equity investment. The investor group would also put up $600,000.00 in exchange for 20% of the

mutual fund management company."

54. On or about June 9, 1996, Shleifer wrote a memorandum to Hay marked "Strictly Confidential" which stated: "Nancy and I had a long talk. We are meeting with AEW on Tuesday PM. ..." On the following Tuesday, June 11, 1996, Shleifer participated in a meeting with Nancy Zimmerman and AEW representatives concerning the proposed investment by AEW and Zimmerman in the depository and mutual fund management company businesses being launched by Hebert, Hay and/or Zagachin.

55. On August 16, 1996, the Russian Securities Commission to which Shleifer and Hay were advisors modified the specialized depository regulations to, among other things, permit a waiver of the requirement for the manager of such a specialized depository to have prior experience in investment funds. This modification enabled Zagachin, who did not have such experience, to be such a manager of the FRSD.

56. On or about August 19, 1996, Shleifer and Zimmerman visited Moscow and had a closed door meeting with Zagachin, Hay and Hebert. Approximately one week later, on August 27, 1996, $400,000, including $200,000 which came from Jonathan Hay's account, was wired from the account of Jonathan Hay's father to Oasis Financial Services ("Oasis"), Zagachin's holding company for the FRSD.

57. On September 3, 1996, the $400,000 which had been

transferred to Oasis by Jonathan Hay's father was used to purchase the FRSD for Julia Zagachin's company (Oasis) from the prior owner.

58. From that time until the time this USAID investigation began in April 1997, Hay and his father provided the $400,000 of required minimum capitalization for the FRSD. At the same time, Hay continued to supervise regulations relating to FRSD, and to direct technical assistance funded under separate contracts by both USAID and the World Bank to the benefit of the FRSD. When Zagachin and Hay learned about the USAID investigation in late March or early April 1997, the money was quickly repaid to Hay and his father.

59. Although Hay and his father transferred the $400,000 to Julia Zagachin's company, Oasis, directly, the transaction was documented as a loan from Hay's father to Hebert, a loan from Hebert to Zagachin, and a loan from Zagachin to Oasis.

60. Zimmerman and Shleifer provided funding and/or capitalization for Pallada as follows:

(a) In or about November 1996, Zimmerman invested approximately $500,000 of her company's funds through the first mutual fund created by Pallada. Shortly after the USAID investigation began, in May 1997, the remaining funds and profits thereon were repaid to Zimmerman's company.

(b) On February 25, 1997, Shleifer wired $200,000 from his and Zimmerman's joint account for the benefit of Pallada. He wired approximately one third to Pallada's landlord and the other two thirds to Boston Capital Management, the holding company for Pallada.

61. The statutes and regulations governing the creation of the Russian Securities Commission and the creation and licensing of these mutual funds and depositories were, to a significant extent, drafted by or in coordination with the USAID funded team under the direction of Hay and Shleifer, which Hay described as the "Russian legal team that I manage."

62. In addition, during the same time period in which Shleifer wired his and his wife's funds to Pallada's holding company and Hay and his father's funds were financing the FRSD, Shleifer and Hay worked on matters pursuant to the Cooperative Agreements relating to capital markets, including specifically the tax treatment of mutual funds.

63. On or about February 26, 1997, just a day after he wired the funds to Pallada, and at a time when the tax experts on the Project had clashed with Hay over capital markets taxation, Shleifer threatened to ostracize the chief tax expert. In particular, Shleifer threatened to ensure that expert's group would be ineffective in Russia if that expert accepted USAID funding for a Russian tax project independent of Shleifer and Harvard.

(iv) <u>Hay's Creation of a Private Real Estate Firm</u>

64. Beginning in the spring of 1996, while still employed full-time on the USAID funded Harvard Project, Hay worked together with Hebert and certain USAID and World Bank funded employees

under his direction to start a real estate development and/or property management business. This business was to team up with Hebert's mutual fund company and CPI to create a real estate mutual fund and to develop and manage real properties in Russia.

65. As part of this plan, Hay was to deliver a public program to which he was an advisor as an anchor tenant for some of the properties his proposed private group would help develop. Hay's private group was to receive a portion of the profit from the rents paid by the public program.

66. In furtherance of this plan, on April 19, 1996, Hay faxed a memorandum to the CPI regarding the "Draft Terms of Agreement", in which Hay confirmed his proposal to "put together a small team ... which would include myself ... to provide real estate services to CPI." Hay proposed to "form an entity jointly with CPI ... that would have the goal of purchasing, developing and managing real estate projects in Russia's regions. ..." The team would be compensated in part by equity in the real estate projects developed, as well as payment on an hourly basis for services rendered.

67. A true and accurate copy of the April 19, 1996 memorandum from Hay to CPI is attached as Exhibit D.

68. Hay also proposed that he and CPI work together with Hebert to found a Russian real estate mutual fund. He wrote in his April 19, 1996 memorandum:

> Real Estate Mutual Fund. The Real Estate Services Group should also form together with CPI a domestic mutual fund to invest in real estate. This project would combine expertise of CPI, [Hay's] Real Estate Services Group, and piggyback on the mutual fund infrastructure being created in the project with Elizabeth Hebert.

69. Subsequently, Hay and CPI had further discussions concerning a proposed real estate venture and, in May 1996, CPI confirmed its understanding that it would form a real estate services company to be owned 50% by CPI and 50% by "Hay & Key Russian Partners (50%)." One of the goals of this company was to "[f]ind and package properties that CPI can purchase and lease," including to a public program to which Hay was an advisor. The proposal specifically noted that "the lower the costs to buy and the higher the rent, the earlier and higher will be [their] profits."

70. Thus, Hay was negotiating a deal by which he would profit personally by charging higher rent to a public program while he was serving as an advisor to and about the program.

71. In furtherance of this plan, Hay and other publicly funded staff under his direction attended a meeting on behalf of this real estate company, which was named Korona. At that meeting, Hay and other publicly funded staff handed out Korona business cards with their names printed on them and solicited business for Korona. Hay also arranged for Korona to receive contracts for managing the offices of the publicly funded advisory organization he was overseeing.

72. Hay was also involved in providing advice to the Russian Securities Commission concerning the creation of a regulatory scheme to permit mutual funds to invest in real estate, while at the same time he was planning to participate in the creation of such a mutual fund himself. Hay took USAID funded staff to Siberia to view potential properties and charged their time and travel expenses to USAID. Hay also used his USAID funded position to assign World Bank funded staff to work for Hebert in launching the proposed real estate mutual fund, and he permitted Hebert to use USAID funded and/or World Bank funded office space for these purposes.

(v) Hay's and Zimmerman's Scheme for Hay, His Father and FFIA to Trade Russian Government Bonds (GKO's) Without Paying Repatriation Tax

73. Hay assisted Shleifer's wife Zimmerman and others at FFIA beginning in late 1995 or early 1996 in creating a scheme to trade in short-term Russian government bonds ("GKO's"), and to repatriate the profits to the United States beyond the limits otherwise permitted by the Russian currency exchange rules. At the time, profits from GKO sales in Russia by foreigners were subject to a substantial tax to prevent foreigners from taking the high returns available on these bonds out of the country.

74. Hay and Zimmerman devised a scheme to repatriate the profits from the GKO trades by disguising the profits as "loan payments" so as to avoid the Russian repatriation tax. FFIA set